
Service Plan Annual Report 2007/08



Forestry Innovation Investment

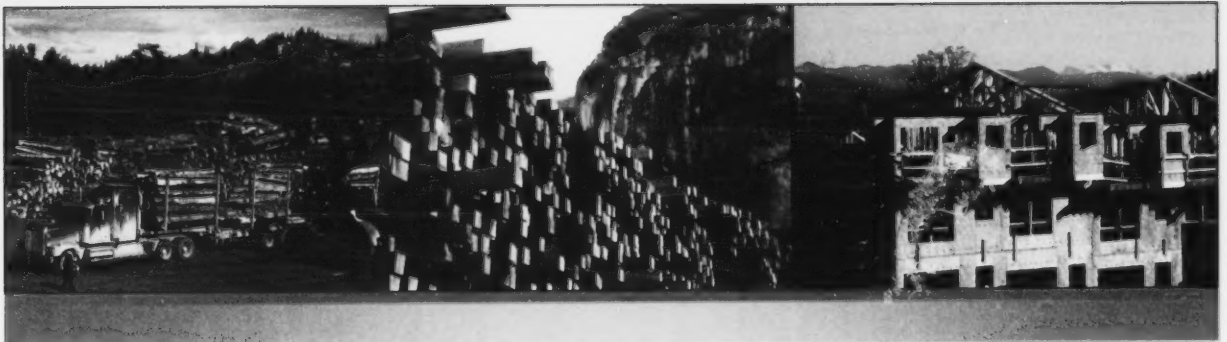


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Message from the Chair to the Minister

June 2, 2008

The Honourable Rich Coleman
Minister of Forests and Range
Province of British Columbia

Dear Minister:

The British Columbia forest industry is struggling through difficult times. In 2007, the province's solid wood products generated \$8.0 billion in sales revenue (down from \$9.8 billion in 2006), while pulp and paper sales garnered \$6.0 billion (up from \$5.7 billion in 2006). Over the last ten years foreign customers have accounted for 84 percent of the revenue from solid wood products, and 90 percent of the pulp and paper revenue. The solid wood sector is especially dependent on sales to the United States.

Because nearly 80 percent of B.C.'s timber harvested is processed in sawmills, and because the industry relies so heavily on export sales, the downturn in housing construction and renovation in the United States has had a dramatic impact on the B.C. industry. Numerous sawmills have temporarily shut down, reducing the amount of wood chips, sawdust and hog fuel feeding the province's pulp mills. This has increased costs for pulp companies and in some cases caused production drops, despite reasonably healthy pulp demand.

Although it is universally accepted that the U.S. will remain our most important market, most experts are now predicting a rebound in the U.S. housing market no earlier than 2010. As a result, numerous firms have expressed a heightened interest in FII's market retention and diversification efforts. Companies that were previously content to sell into the U.S. and Japan have shown an increased appreciation of the value of long-term diversity, and have begun to seek customers in China, Korea, and elsewhere.

With that context, I am pleased to outline some of the ways FII assisted the forest industry to retain existing markets and diversify.

Mountain Pine Beetle epidemic

The Mountain Pine Beetle epidemic has affected an estimated 13.5 million hectares in the Interior of the province. FII is responsible for the product development and marketing component of the Province's mitigation program, and over the three years to the end of fiscal 2007/08 was allocated a total of \$5.85 million towards related activities. In 2008/09 FII plans to continue pursuing new uses for the dead timber, drawing upon its normal market development program funding and shifting the focus from lumber production to the feasibility of composite products, and eventually bio-energy.

Coastal industry

Over 60 percent of the coastal timber supply consists of hemlock and balsam fir, which are typically marketed together as "hemfir". Since the mid-1990s that species mix has suffered from declining demand in Japan, where it had previously been favored for construction of traditional post-and-beam houses. Over the past year, about one-third of FII's expenditures were aimed specifically at assisting the coast industry in their successful promotion of a new line of kiln dried products in Japan. Despite the absence of shipments from B.C. during the 3-month-long woodworkers strike, B.C.'s share of Japan's 2007 softwood commodity imports remained virtually unchanged from 2006.

The other major species on the Coast is western red cedar. FII's single largest funding envelope to other organizations in 2007 was in support of the industry's red cedar promotional activities aimed at architects and consumers in the United States.

Finally, FII continued to directly deliver market communications to foreign customers and regulators to make them aware of world-class forest management on the Coast, especially with respect to the new land-use plans for the Central and North Coast.

Business Innovation Program

The value-added sector is a critical part of the B.C. forest industry, accounting for nearly half of the revenues from solid wood products. I am pleased to confirm that FII's new Business Innovation Program was launched in late 2007 to assist mostly small and medium-sized businesses with market research, product design and development, sourcing capital and raw material, business planning, and manufacturing improvements.

Asia Pacific strategy

Consistent with B.C.'s Asia Pacific Strategy, FII places a high priority on market investments in Japan, China, and Korea. Twenty-eight percent of last year's investments went to those areas.

The program in Japan was delivered by trade associations, funded in part by FII. The associations continued to concentrate on promoting Coastal species in post-and-beam housing construction, interior species in platform frame housing construction, and a range of value-added products generally.

In China, FII and trade associations collaborated on introducing wood frame construction to Chinese regulatory officials, developers and builders, as well as demonstrating the merits using B.C. species for outdoor landscaping. More than ever we are convinced of the huge potential in mid-rise apartment construction and in landscaping, but recognize that, as was the case in developing the Japanese market 30 years ago, it will take some years before Chinese interests fully appreciate and accept what B.C. has to offer in meeting their needs.

The prospects in Korea, although ultimately a fraction of those in China, are closer at hand. Koreans already favour wood frame construction for single-family houses, and are familiar with B.C. landscaping products. Partially funded by FII, Canada Wood Group opened an office in Seoul in late 2006 and settled into place in 2007. In late 2007/08 FII commissioned a comprehensive market development strategy that will guide the private-sector delivery of the Korea program.

Elsewhere in Asia, the furniture industry in Vietnam is growing exponentially. In 2007/08 FII organized a first-time presence at a large furniture manufacturing trade show in Vietnam, at which several B.C. firms made first-time sales to Vietnamese customers.

Finally, in the past year FII and BCIT's School of Construction and the Environment jointly facilitated the Government of Mongolia's adoption of the wood frame component of Canada's building code, and are collaborating on construction of two demonstration houses that we hope will lead to significant commercialization.

Forest certification in China

China exports a huge volume of forest products to North America and Europe, where customers are sensitive to the environmental pedigree of the products they buy. Many of those products are made from imported fiber. To ensure foreign customers are satisfied products originated in well managed forests, Chinese officials are developing a made-in-China certification system by which independent parties can attest to the quality of forest management underlying their products. On behalf of an informal consortium of interests in Canada, the United States, Australia, Chile and Europe, FII is employing a representative in Beijing who is working with Chinese officials to ensure that China's new forest certification system does not discriminate against the systems employed broadly in those countries.

The green building movement

Green building involves adopting a host of environmentally friendly approaches to the construction of new buildings. The green building movement has proliferated in the design and construction of non-residential structures in North America, Europe and Japan, and is beginning to take hold in residential construction. FII has expanded its marketing approach from discussing sustainable forest management, to discussing the inherent environmental merits of B.C. forest products.

Olympic Games

Increasing the use of wood in non-residential buildings offers tremendous growth potential for lumber, paneling, laminates and engineered wood products. Development of this market is strongly supported by the B.C. forest sector, and FII is using the 2008 and 2010 Olympic Games to promote wood use in the commercial and institutional building sectors.

In 2007/08, FII facilitated procurement of appearance-grade wood products for the B.C. Canada Pavilion in Beijing, and provided much of the electronic imagery that will be highlighted in the Pavilion during the 2008 Olympic Summer Games.

FII was instrumental in incorporating the world's first "wood wave" roof in the Richmond speed-skating oval, and contributed to showcasing B.C. appearance-grade wood products in the expanded Vancouver Convention Centre. In part with FII funding, the Canadian Wood Council has provided technical assistance to incorporating B.C. wood products in other 2010-related structures, including the Sliding Center, Nordic Centre and Athletes' Village at Whistler, and the Curling facility in Vancouver.

With venue construction well underway or complete, FII is shifting the focus to creating communications materials for deployment before, during and after the Games. The target audiences will be architects, engineers and developers who are visiting B.C. for the Games, or are being exposed by way of television and print media.

Low-cost housing

FII learned a great deal through its demonstration project in Indonesia following the 2004 southeast Asia tsunami, lessons that are being applied in introducing wood frame housing to Mongolia. Better understanding of costs, organizational logistics, and how to work with government and aid agencies will help FII become involved more quickly and substantially if and when other natural disasters strike, or when foreign interest arises in respect of low-cost housing more generally.

Risk and capacity

The most important factors affecting forest product sales are beyond FII's control. Demand for B.C. products is driven mostly by the level of economic activity in other countries, especially residential construction and renovation in the United States. Furthermore, the competitiveness of B.C. firms is critically tied to the strength of the U.S. dollar and the Japanese yen, both of which were at historically low values in 2007.

Half of FII's programming is by way of sharing the cost of activities proposed and ultimately delivered by other organizations. Despite a dramatic turn-down in profitability in 2007, the B.C. forest industry demonstrated its support for FII's market development activities by continuing to share the cost of work done by the trade associations. I am pleased to report that the industry is continuing its efforts in 2008/09 despite its current financial difficulties.

From a fiscal perspective, in 2007/08 cash expenditures by FII, either directly or through funding provided to other organizations, totalled \$22.030 million, which was \$4.720 million less than the total allocated to FII by the Ministry. The reasons for under-spending are outlined later in this report.

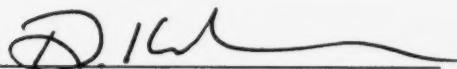
Although it is difficult to quantify the return on FII's continuing investments, I am pleased to report that an independent survey of FII's stakeholders in early 2008 confirmed they believe FII is doing a good job in pursuing the right priorities and strategies. I am also pleased to report that FII achieved all of its internal performance targets for 2007/08, as documented in the body of this report.

The 2007/08 Forestry Innovation Investment Ltd. Annual Report was prepared under my direction in accordance with the *Budget Transparency and Accountability Act*. I am accountable for the contents of the report, including what has been included in the report and how it has been reported.

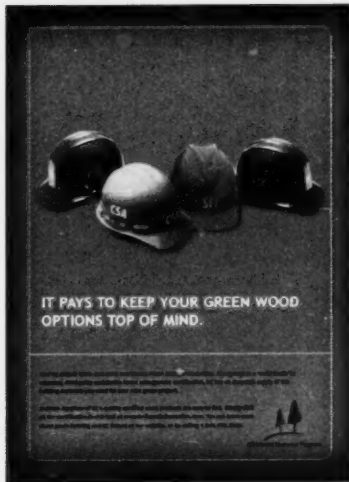
The information presented has been prepared in accordance with the B.C. Reporting Principles and reflects the actual performance of FII for the 12 months ended March 31, 2008 in relation to the January 2007 service plan. The measures presented are consistent with FII's mission, goals and objectives for 2007/08, and focus on aspects critical to the organization's performance.

I am responsible for ensuring internal controls are in place to ensure performance information is measured accurately and in a timely fashion.

All significant decisions, events and identified risks, as of March 31, 2008 have been considered in preparing the report. The report contains estimates and interpretive information that represent the best judgment of management. Any changes in mandate direction, goals, objectives, strategies, measures or targets made since the January 2007 service plan was released and any significant limitations in the reliability of the data are identified in the report.



Doug Konkin
Board Chair



Highlights

In 2007/08 FII delivered on its mandate through market outreach, market development, and programs targeted to industry priorities. From top:

- Market outreach raised awareness of wood as a green building material and the large percentage of B.C. forests that are certified to international standards as being sustainably managed
- Several mill trials were carried out in B.C. sawmills to help industry adapt manufacturing processes to the fibre quality of Mountain Pine Beetle wood; FII plans to continue its MPB research and product development program in 2008/09 that was funded through the 2007/08 fiscal year as part of the *Mountain Pine Beetle Emergency Response—Canada B.C. Implementation Strategy*
- Market development supported promotional activities by industry associations under the Canada Wood brand in Asia and Europe
- Efforts to raise Chinese interest in building with wood achieved a major milestone with the completion of the first commercial reroofing project using B.C. wood and Canadian design technology; thousands of apartment buildings in China require renovations and upgrades, including new roofs



Organizational overview

Why FII exists

Forestry is British Columbia's largest manufacturing sector, generating about 15 per cent of economic activity, and directly employing more than 81,000 people in communities across the province. This makes a healthy forest economy vital to the economic and social well being of the province.

The large size of the B.C. forest economy is due to the many foreign customers who buy more than 75 per cent of the softwood commodity products that the industry produces. International demand has made British Columbia the world's largest supplier of softwood lumber, but has made the sector highly reliant on these markets for continued growth and profitability. Developing and diversifying foreign markets for B.C. wood products, therefore, is important both to the forest sector and to provincial society as a whole.

B.C. softwood commodity products: 2007 shipments (Softwood lumber, plywood, OSB, MDF and particleboard)

Within Canada	10.054 million m ³
Outside Canada	<u>30.918 million m³</u>
Total	40.972 million m ³

Reflecting the importance of international markets to the forest economy, Forestry Innovation Investment Ltd. (FII) was incorporated on March 31, 2003 under the *Business Corporations Act* as a provincial Crown agency with a goal to develop and diversify markets for B.C. wood products around the world.

A Shareholder's Letter of Expectations from the Minister of Forests and Range, signed in November 2006 and updated in February 2008, confirmed the organization's mandate as working collaboratively with the forest sector in promoting B.C.'s sustainable forest products in domestic and international markets.

What FII does

FII delivers its mandate through Market Development and Market Outreach activities.

Market Development focuses on growing sales for B.C. wood products by:

- Co-funding industry marketing programs along with federal and industry contributions
- Investing in new product research and development
- Researching emerging market opportunities
- Promoting B.C. wood products and advanced wood technologies through demonstration projects and trade shows
- Working with foreign governments to overcome trade restrictions and other market access issues.

FII administers seven Market Development programs, one of which is delivered through a wholly owned subsidiary in China, known as FII Shanghai, that collaborates closely with industry in opening up the Chinese market to B.C. wood products.

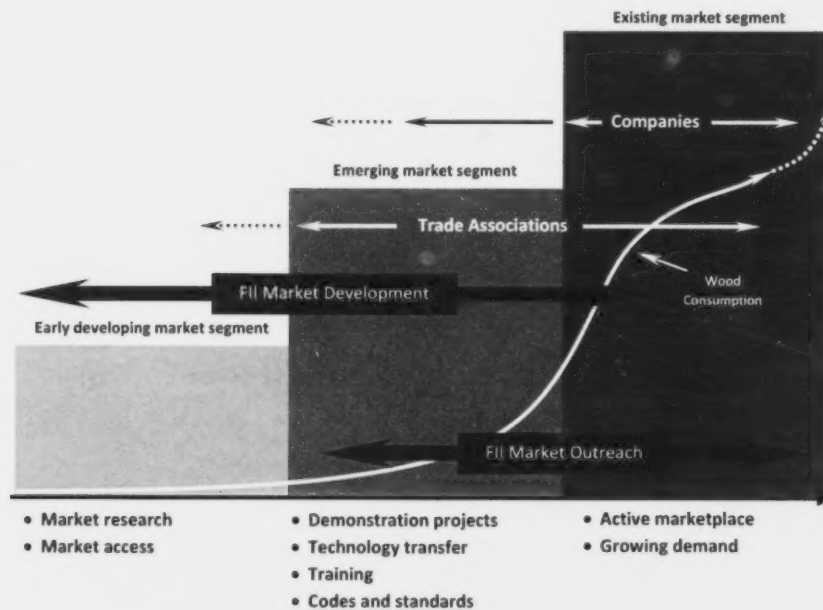
Market Outreach was established to promote B.C. forest practices and the environmental merits of B.C. wood products. Historically known as the BC Market Outreach Network, the initial focus was on countering campaigns that inaccurately discredited B.C. forest practices in order to convince buyers to switch to other suppliers, and/or demand changes in B.C. forest management.

Reflecting the rapid growth of the "green" economy, outreach programs were broadened in 2007/08 to promote wood as a "green building" product and explain the role of forest management and forest products in the context of global warming and carbon emissions and sequestration.

How FII delivers its services

FII works collaboratively with the federal government and the B.C. forest industry to maintain and grow demand for B.C. wood products. In doing so, FII does not duplicate the efforts of trade associations or provide business subsidies. Rather, the emphasis is on leveraging the value of marketing programs through targeted investments and delivering services of a general benefit to the sector, such as market outreach, research and demonstration projects. FII is first and foremost a funding agency, supporting activities proposed and ultimately delivered by trade associations, universities, and research institutes.

The following graphic illustrates FII's relationship to industry activities:



In delivering its Market Development and Market Outreach programs, FII responds to industry priorities with targeted programs, including how to economically process pine trees killed by the Mountain Pine Beetle epidemic, how to use the 2010 Olympic and Paralympic Winter Games to showcase B.C. products, and how to introduce North American wood frame building technology in China.

FII's key stakeholders and partners include:

- B.C. forest product companies
- Forest industry trade associations
- Academic and research institutions engaged in forest product studies
- Natural Resources Canada and Canada's foreign consulates and embassies
- Provincial ministries and agencies
- Municipal governments in rural B.C.

FII Shanghai partners included Chinese government agencies, several Canadian consulates and embassies, and numerous B.C. forestry company representatives in China and Canada.

FII funding

FII is funded entirely by the Ministry of Forests and Range. About half of FII's funding is used to partially or fully pay for activities that other organizations propose and implement according to FII's overall investment strategy. Much of this work is jointly funded by FII, industry, and Natural Resources Canada through its *Canada Wood Export Program*. For 2007/08 project costs were split as follows:

FII	45%
Natural Resources Canada and other federal agencies:	33%
B.C. forest industry:	22%

On a project basis, FII's investments in 2007/08 leveraged more than \$12.4 million of additional spending by industry and the federal government, resulting in total market development initiatives of almost \$24 million.

FII's strategic focus

FII's strategic direction reflects its mandate.

Vision: Forestry Innovation Investment Ltd. is an effective catalyst in positioning British Columbia as the leading global supplier of products from sustainably managed forests.

Mission: FII's mission is to be an innovative and collaborative forest marketing agency that anticipates and meets the needs of government, the B.C. forest sector, and international markets through well balanced investments that maximize the value to British Columbia.

Values:

Focus on partnerships – FII works in partnership with key stakeholders to develop initiatives and ensure programs are effectively delivered in a coordinated manner.

Innovation – FII encourages innovative programs and responses to changing circumstances. FII staff learn from the past and continuously improve the effectiveness and efficiency of FII programs by consulting widely and optimizing the use of resources.

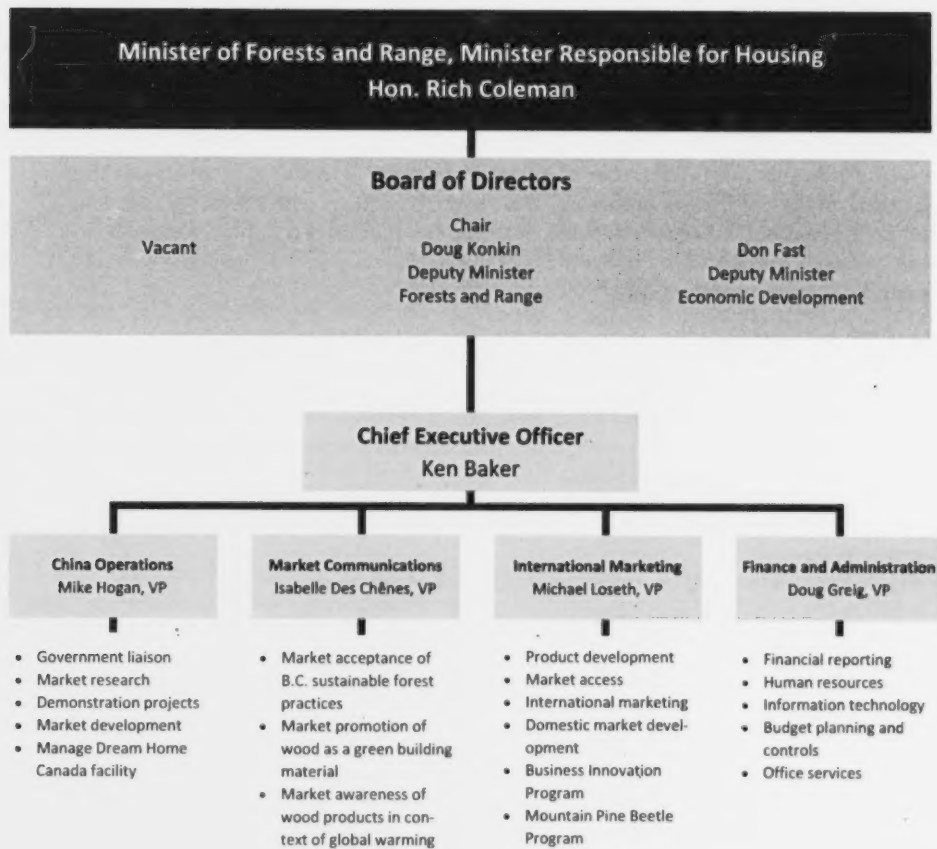
Integrity and Credibility – Projects and services are delivered by capable, motivated individuals who focus on ensuring FII programs are credible and useful.

Investments based on knowledge and excellence – FII strives for transparent decision-making and investment processes based on research.

Additional information

More information on FII is available at www.bcfii.ca. The "About FII" section includes copies of service plans, annual reports, and a corporate governance page with the Shareholder's Letter of Expectations, a report on the Status of Concurrence with Best Practice Guidelines, and terms of reference for the board of directors.

General information on B.C.'s high-quality forest products and sustainably managed forests is available at www.bcforestinformation.com.



Board of directors: The board is responsible for interpreting direction given in the Shareholder's Letter of Expectations, providing strategic direction to the FII executive, approving the corporation's policies, priorities and strategies, and ensuring sound fiscal and administrative practices. The board members include Doug Konkin (Deputy Minister of Forests and Range), and Don Fast (Deputy Minister of Economic Development). A third position has been vacant since July 2007 when the previous Deputy Minister of Finance resigned her position.

Audit committee: The board's audit committee reviews, recommends, and in some instances approves financial statements and other financial information. Members are: Doug Callbeck (Assistant Deputy Minister of Management Services, Ministry of Economic Development) and Joan Elangovan (Assistant Deputy Minister of Corporate Services, Ministry of Forests and Range). One position is vacant.

Subsidiary company: FII incorporated a wholly owned subsidiary registered under the laws of the People's Republic of China – FII Consulting (Shanghai) Co., Ltd. – in March 2003. As a wholly foreign-owned enterprise, FII is registered to provide consulting services to FII and others. These facilities, along with rented office space in Beijing, serve as a common base of operations from which FII China and the members of the Canada Wood Group are pursuing their marketing and promotional activities in the Chinese market.

The subsidiary's year end is December 31 while FII's year end is March 31. Chinese law imposes restrictions on the distribution of earnings and other transactions with the foreign subsidiary based on the laws of the People's Republic of China. The subsidiary is entirely funded by the parent company, and the yearly transactions of the subsidiary are reflected in the Financial Statements of the parent Company.

FII Shanghai does not have its own board of directors. In accordance with Chinese law, it is led by its Executive Director, who is Ken Baker, CEO of FII.

Corporate locations: FII's corporate office is located at 1200 - 1130 West Pender Street in downtown Vancouver, British Columbia, while the company's subsidiary office is located in Shanghai, with a satellite office in Beijing.

Governance principles: FII's corporate governance framework is founded on six guiding principles related to:

- Stewardship, leadership and effective functioning of the board
- Clarity of roles and responsibilities
- Openness, trust and transparency
- Service and corporate citizenship
- Accountability and performance
- Value, innovation and continuous improvement.

Details about how the guiding principles are applied are posted on FII's website at:
http://www.bcfii.ca/about_fii/corporate_governance.htm.

Governance Practices: FII is substantially in accordance with governance best practices published by the Board Resourcing and Development Office. A detailed disclosure of concurrence is posted on FII's website at
http://www.bcfii.ca/about_fii/corporate_governance.htm.

Report on performance

Economic and industry factors

Global softwood lumber/sawnwood demand peaked in 2005 at 315.7 million m³ when U.S. housing and consumption topped out. In 2006, a weakening U.S. housing market lowered global demand slightly to 314.2 million m³. Global production followed this trend, with a slightly over supply in 2005 at 320 million m³, dropping to 317.5 million m³ in 2006.

Heading into 2007/08, FII's projections were similar to the industry's: the U.S. housing downturn would accelerate, the Japanese market would be relatively stable, and other markets would grow, particularly in other areas of Asia-Pacific. Because about 82% of B.C. softwood commodity exports go to the U.S. market, the American downturn was expected to be particularly difficult for the industry, with lower prices and a sharp drop in sales volume predicted.

FII responded to this forecast by investing about 30% of the budget for funded marketing activities, or \$2.99 million, in U.S.-directed activities. FII also worked to diversify markets away from the U.S. – a long-term strategy of FII's – and take advantage of growing demand in other markets – by targeting almost half of investments in Asia.

As reported in Goal 1, although U.S. sales were down significantly, B.C. increased its market share in Asia. Sales to developing markets were up substantially.

FII also recognized that the U.S. downturn, through its impact on industry revenues and profits, would put pressure on the ability of industry associations to co-fund international marketing activities. Since industry contributes about 20% of project costs, on average, this situation has the potential to have a significant impact on market development programs. FII responded through cost saving initiatives, such as sharing office space and services in overseas offices, streamlining administrative procedures for funding recipients, and budgeting a record \$11.5 million in other organizations' marketing programs.

The actions taken in response to the projected downturn in the U.S. reflected FII's annual updating of business priorities to reflect the issues and opportunities facing the forest economy. FII also responded with the following initiatives:

Situation	FII response
Mountain Pine Beetle epidemic	
FII is responsible for the wood products research and development component of the <i>Mountain Pine Beetle Emergency Response – Canada-B.C. Implementation Strategy</i> , and the related \$5.85-allocation from the Ministry of Forests and Range from 2005/06 through 2007/08.	2007/08 funded projects focused on manufacturing processes, product development in composite paneling and engineered wood products, and research in bio-products. Based on industry feedback and the need for more research, FII plans to continue the program in 2008/09 after funding from the strategy ends; the program will be integrated into the regular FII budget.

Coastal industry	
High production costs in harvesting and processing old-growth timber, changing market preferences, and a shift to second-growth harvesting are placing added pressure on the coastal industry.	FII targeted investments in 2007/08 to develop new uses for Hem-Fir and build market demand for products like kiln-dried Hemlock (Canada Tsuga) in overseas markets. FII activities were integrated with the government's Coastal Action Plan.
2010 Olympic and Paralympic Winter Games	
The Games offer a high profile opportunity to promote wood use in commercial buildings and larger structures.	FII continued its program of promoting wood use in venues, including the world's first "wood wave" roof on the Richmond speed skating oval, and appearance grade products in the expanded Vancouver Convention Centre. FII fully funded the work of BC WoodWORKS! to assist architects and engineers to incorporate more wood into a number of other 2010-related structures.
Non-residential sector	
In North American markets, wood is the dominant building material for single family homes, but has a lower market share for multi-family residential buildings and commercial and institutional buildings. Expanding into these markets offers tremendous growth potential for wood products.	In 2007/08 FII and the forest industry jointly funded implementation of a new program to promote structural wood in non-residential buildings, with organizations established in California and Georgia. FII continued to share the cost of BC WoodWORKS! assistance to architects and engineers in their design of other high-profile wood structures such as the Castlegar city hall.
Affordable housing	
Continued urbanization in developing countries is creating an enormous demand for permanent housing. Wood-frame housing is increasingly cost competitive and more energy efficient than competing formats (concrete or cement block).	Building on the experience gained from providing housing to Indonesia following the 2004 tsunami, in 2007/08 FII collaborated with the B.C. Institute of Technology to assist the government of Mongolia in adopting the wood frame component of the Canadian building code, and negotiated a housing demonstration project to be undertaken in 2008. FII plans to use the project to promote wood frame construction in Mongolia as well as in other developing markets
Value-added sector	
With \$4.85 billion in revenue in 2006, the sector is an important part of the forest economy, but with more than half of the companies employing fewer than 15 people, it can be difficult to compete with overseas manufacturers or move into international markets.	In 2007/08 FII introduced a new Business Innovation Program to assist value-added firms in updating their business planning, technology and marketing activities. The program will be fully implemented in 2008/09.

Asia-Pacific economic strategy	
British Columbia has placed a priority on strengthening trade ties with the Asia-Pacific region.	In 2007/08 FII directed 57% of international marketing investments to the Asia-Pacific region (excluding investments across all markets and in B.C.). FII supported trade tours by the Premier and Cabinet Ministers to Japan, Korea, China and India. FII Shanghai opened an office in Beijing, China to work more actively with national government agencies in order to have building and fire codes amended to accommodate North American wood frame technology. FII facilitated the provision of B.C. wood products for the B.C.-Canada Pavilion at the Beijing Summer Olympics, and provided much of the electronic imagery that will be displayed in the Pavilion. Canada Wood Group established its office in Seoul, Korea, funded in part by FII.

Risk management

In 2007/08 FII fully implemented its risk management framework that identifies potential risks to discharging its mandate, and strategies for mitigating those risks. The framework is based on the Province's enterprise-wide risk management strategy adapted to FII's structure and business activities. Risk factors are identified for corporate, market development, market communication, China operations, and financial and IT services.

External business environment: The international demand for B.C.'s forest products is influenced by macroeconomic factors and demand in various markets. The strength of the Canadian dollar against the U.S. dollar and the Japanese Yen – an indicator of B.C. competitiveness – and the demand for new housing in the U.S. and Japan – an indicator of demand for wood products – are among the most important influences on exports.

These factors are well beyond FII's control. However, through a forward-looking planning process, and the annual updating of investment strategies and business priorities, FII aligns its activities to reflect changing market conditions. Through market diversification and product development activities FII helps the forest industry reduce the risks related to specific market and product dependencies.

Partnerships: Success in delivering FII programs depends on the willingness of other parties to propose activities that benefit the forest economy, and deliver projects that achieve the intended objectives. On the first point, FII reduces the risk of inappropriate or misguided proposals by seeking industry input during the annual cycle of developing investment and business priorities. On the second point FII requires frequent and regular program updates through a new, online compliance system introduced in 2005/06. Where projects are not on target, FII works with its partners to resolve any issues or shortcomings.

Performance targets and indicators

For 2007/08 FII updated its performance measures to provide a more concise, higher-level statement of expectations and to make activities more easily understood by non-industry readers. The performance measures are based on three over-arching goals:

Goal 1: Expanded market opportunities that are beneficial to the B.C. forest sector

Goal 2: International recognition of B.C. as a leader in sustainable forest management

Goal 3: FII positioned as a highly effective, innovative and responsive organization.

Goal 1 was changed so that it refers to "expanded" market opportunities instead of "diversified" market opportunities. The change was made because FII's Industry Strategy Committee argued that "expansion" includes not only diversification, but also retention and growth in existing markets, and is a more accurate characterization of the goal. The previous Goal 3 of collaboratively delivering market development activities was dropped as a goal because it is in fact a way of delivering programs, and not a goal unto itself. Collaboration is noted in the FII Mission, implied in the FII Values, and reflected in several of the objectives listed under various goals.

FII is not aware of any other organization that pursues the same set of fundamental goals, or operates in the same fashion. Hence there do not appear to be any available benchmark comparisons for FII's performance measures, targets, and performance which are summarized in the following pages.

Goal 1: Expanded market opportunities that are beneficial to the B.C. forest sector

Given that the B.C. forest industry exports more than 75% of the softwood commodity products that it produces, market expansion is vital to the growth and long-term prosperity of the sector. Reflecting the importance of market development, FII tracks B.C. wood product sales in major markets as an indicator of industry growth and competitiveness.

Summary of B.C. Commodity Wood Product Shipments and Exports—2007
(X000 m³)

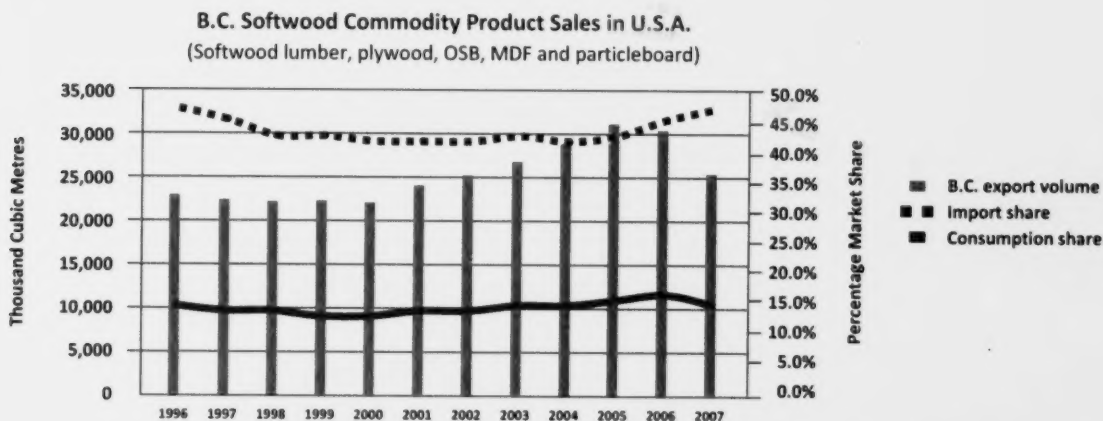
	Softwood Lumber	Softwood Plywood	OSB	MDF	Particle Board	Total Excl. Logs	% of Exports
Total Shipments	36,822	1,677	2,090	265	230	41,084	
Shipments to Canada	8,579	1,230	232	51	74	10,166	
Exports							
US	22,975	366	1,580	181	156	25,258	81.7%
Japan	2,807	37	176	1	0	3,021	9.8%
China (incl. HK)	727	1	9	9	0	745	2.4%
Taiwan	356	0	3	6	0	366	1.2%
S. Korea	245	0	49	5	0	299	1.0%
Other Asia	204	0	0	0	0	204	0.7%
Australia	73	0	0	0	0	73	0.2%
New Zealand	17	0	0	0	0	18	0.1%
Europe (EU)	426	34	6	2	0	467	1.5%
Other	415	8	35	10	0	467	1.5%
Total Exports	28,243	446	1,858	214	156	30,918	100.0%
% Export Shipments	77%	27%	89%	81%	68%	75%	
% of Tot. BC Exports	91.3%	1.4%	6.0%	0.7%	0.5%	100%	0.0%

Source: Statistics Canada, COFI, WOOD Markets

Note: For particleboard and MDF, production is used instead of shipments

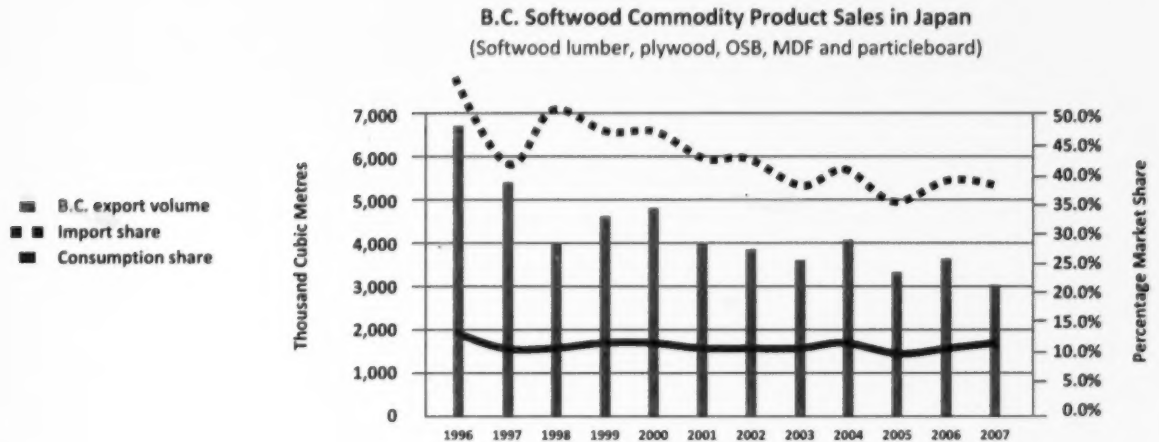
Overall, 2007 was a year of weak sales for the B.C. solid-wood forest industry. Industry shipments were down 5 million m³ from 2006. Exports were 86% of 2006 levels at 31 million m³.

Most significant was the drop in sales to the United States:



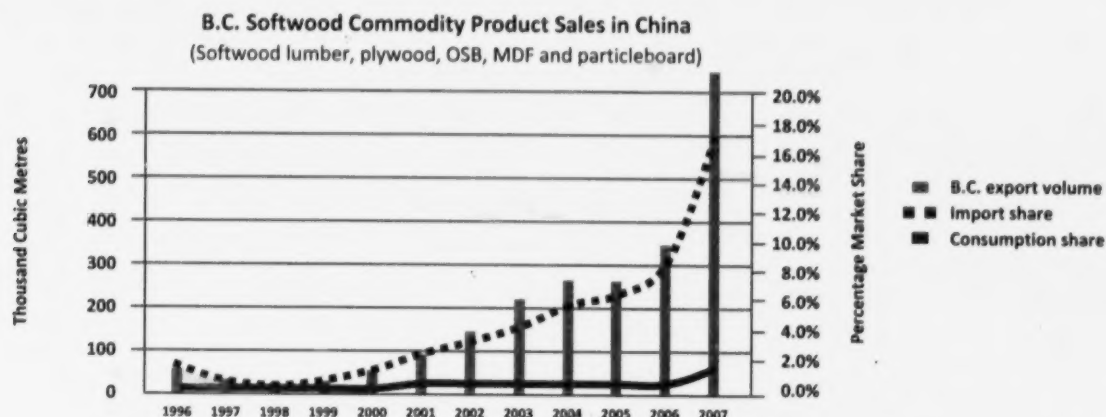
As noted in Economic and Industry Factors, 2007 had been projected to be a year of declining sales in the U.S. due to the downturn in the housing market. Results bore out this prediction, as B.C. sales of softwood lumber dropped by 17% to 23 million m³, a five-year low. FII's funding of industry marketing activities in the U.S. was designed to strengthen the industry's position relative to competitors. In this regards, B.C. did well, as it increased its share of imported softwood products to 46.5% of sales, the highest share.

Sales also declined somewhat in Japan:



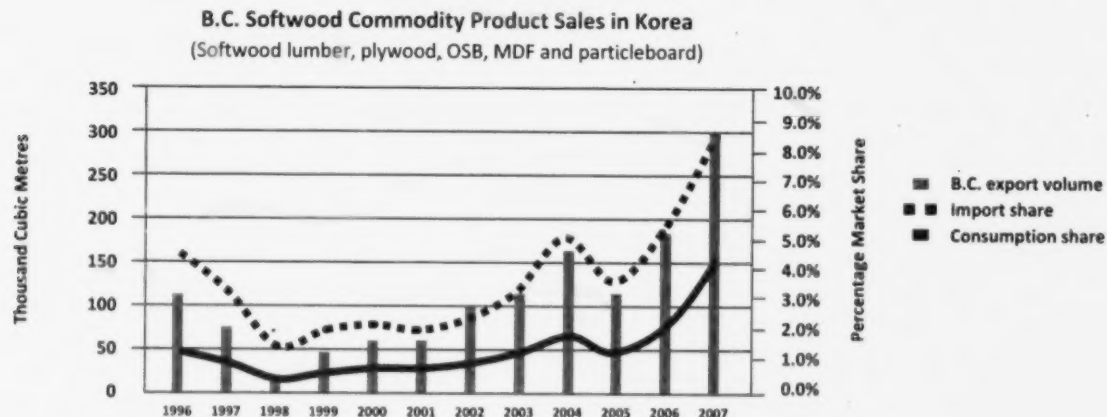
Japan is B.C.'s second largest foreign market, but a mature market with an aging population and a steady long-term decline in wood demand. Although imports in the first six months of the year were strong, demand plummeted with the implementation of the revised Building Standard Law in June 2007. Import reductions were especially severe in the fourth quarter of 2007 while implementation issues with the new building standards were being addressed. Combined with the forestry strike on the B.C. Coast, the reduction in housing activity caused B.C. shipments to drop by about 19% in 2007. Market share held its own at 38% for softwood commodity products and the share of total consumption edged up to 12%.

In contrast to shipments to the U.S. and Japan, sales to China increased dramatically in 2007:



Sales to China were a large factor in the 46% increase in softwood lumber shipments to non-U.S./Japanese foreign customers. B.C. increased market share of imported products and total consumption, reflecting the continuing efforts of FII and industry through the Canada Wood Group to promote wood use in China.

Koreas was another good-news story for the B.C. industry in 2007:



Softwood sales to Korea increased by about 34% in 2007. B.C. has a 47% market share of the softwood lumber (import) market and is well positioned for further growth. The forest industry, supported by FII, has been expanding activities in recent years and commissioned an updated comprehensive marketing strategy for Korea in late 2007. Projections are that sales could increase five-fold over the next 15 years.

The 2007/08 service plan included a chart combining exports to China, Taiwan and South Korea. That chart has been replaced by the above separate charts for China and Korea. Taiwan has not been included because it remains of minor interest to the B.C. industry. Unless market conditions change, statistics from Taiwan will not be included in future service plans.

Performance measures for Goal 1:

To achieve Goal 1, FII's strategies include:

- Increasing demand and acceptance of Canadian wood products through promotional activities.
- Increasing the level of, or prevent the loss of, market access for Canadian wood products by developing or refining foreign codes and standards and dealing with plant health issues and non-tariff barriers.
- Ensuring that international architects, builders, officials and other key influencers have the necessary skills and information to specify and use B.C. wood products.
- Ensuring that overseas office infrastructure is in place to deliver effective programs.
- Increasing the competitiveness of B.C. wood products producers by improving their awareness and use of new and existing technologies, products and processes.
- Conducting market research to identify opportunities, barriers, market size and strategies for Canadian wood products.
- Promoting increased wood usage in recreational, commercial, institutional applications.
- Obtaining higher value for B.C. wood products by improving existing wood products and developing new products and processes.
- Maximizing opportunities for fibre impacted by natural disturbance agents (e.g., Mountain Pine Beetle, forest fires, etc.).

Measure: Level of key stakeholder support for development and delivery of market development programs, as measured in bi-annual surveys (on a scale of 1 to 5)
Target: Achieved

Past performance		2007/08		Future performance targets	
2005/06	2006/07	Target	Actual	2008/09	2009/10
3.8	No survey	4.0	4.0	No survey	4.0

Importance of measure: Stakeholder support is a direct indicator of the relevance of market development activities. Data is gathered through a bi-annual survey of about 60 industry and government stakeholders. The survey is conducted by an independent research firm, and given that some opinions are certain to be neutral at best, FII believes maintaining an average of 4.0 is reasonable and realistic.

The survey conducted in the fourth quarter of 2007/08 found that respondents rated the importance of FII's market development activities as 8.5 out of 10 with no major rebalancing of services required. Their "overall impression" of FII rated an aggregate score of 7.9 out of 10.

98% of respondents found market research reports useful in making decisions on entering new markets or developing new products, and 100% found FII staff as helpful and receptive. Respondents scored FII as 5.3 out of 10 in terms of its approach to funding, with 5 being the best balance between being too restrictive and too accommodating in the use of public funds.

Measure: Financial contribution of key partners to projects partially funded by FII					
Target: Exceeded					
Past performance		2007/08		Future performance targets	
2005/06	2006/07	Target	Actual	2008/09	2009/10
56%	51%	50%	55%	50%	50%

Importance of measure: The willingness of the federal government, and especially of the B.C. industry, to contribute to marketing activities is a direct indicator of how valuable they believe these activities to be. Given the need to deliver profits and returns to shareholders, industry associations will only participate if they see real value in the programs. Despite the difficult times facing the sector in 2007/08, industry maintained a significant contribution level to FII-supported marketing programs.

The cost-sharing outcomes will vary each year because of a changing mix of activities. Most projects are marketing activities that FII funds in the 35% to 50% range, depending on federal government participation. Other types of projects, such as market research, could qualify for up to 100% funding. Since 2005/06 there has been a shift to associations focusing more on marketing activities and FII directly managing market research. This has been reflected in the new target levels of 50%.

Measure: Number of new products developed from timber killed by the Mountain Pine Beetle epidemic					
Target: Achieved					
Past performance		2007/08		Future performance targets	
2005/06	2006/07	Target	Actual	2008/09	2009/10
3	4	4	4	New measures are under development	

Importance of measure: FII's role in the B.C. Mountain Pine Beetle Action plan focused on research and development targeted to the immediate issues facing the industry. The results of these efforts – new manufacturing processes and products – have been a relevant indicator of the usefulness of the FII program. In 2007/08, FII funding helped to develop:

- A new method for hardening and coloring pine flooring.
- A new laminated veneer lumber product using pine veneer for the core, and coastal species for the outer strands.
- Glue laminated stock using pressure treated pine lumber.
- A new method of recovering hemicelluloses from dead pine wood chips.

With the continued aging of MPB timber, industry concerns are shifting to concerns about fibre quality. As a result, with industry input, FII is updating its role and performance measures accordingly. New targets and results will be reported in the 2008/09 annual report.

Measure: Number of new demonstration projects in China
Target: Exceeded

Past performance		2007/08		Future performance targets	
2005/06	2006/07	Target	Actual	2008/09	2009/10
Nil	2	2	4	2	2

Importance of measure: Promoting wood use in China requires showing Chinese officials, developers, architects, engineers, and consumers the practical use and benefits of wood products in local Chinese situations. Demonstration projects are the best means of achieving this goal. The FII office in Shanghai – the Dream Home Canada centre – is a demonstration site of several commercial and residential buildings. The number of projects achievable in a given year depends on the willingness of Chinese participants, and on the complexity of the projects.

Highlights in 2007/08

- **Roof renovation:** Shanghai's first commercial wood truss roof renovation project was completed following a successful demonstration projects in partnership with Xu Hui District and Tongji University in Shanghai. This municipal government led project involves the renovation of 20 buildings in a low-income community and signifies the first commercial acceptance of the wood truss roof system.
- **Structural wood in-fill floor and partition wall demonstrations:** FII Shanghai and the Canada Wood Group provided quality assurance for two demonstration projects introducing structural wood in-fill floor and partition wall systems in bi-level, high rise apartments. Like the roof renovation market, the market for interior wall floor and partition wall systems, is an entry point into the much larger multifamily hybrid market.
- **Landscaping and wood frame demonstrations:** The Guangdong – B.C. Pacific Gateway Park demonstration projects (where Premier Gordon Campbell turned sod in November 2006) officially opened in January 2008. In collaboration with Guangzhou municipal officials, FII completed a large-scale landscaping project, as well as two innovative wood frame buildings. The projects were the initial phase of a three-year MOU with Guangzhou Garden Bureau, aimed at introducing B.C.'s outdoor wood products, including cedar and pressure treated Balsam Fir and Lodgepole Pine, for use in South China.



Goal 2: B.C. is recognized as a leader in sustainable forest management

Forest product customers around the world are increasingly looking for assurance from their suppliers that the products they purchase come from legal and sustainably managed forests. As a result, B.C. must be well positioned as a global leader in sustaining environmental values and forest resources.

The province's commitment to sustainable forest management represents a significant advantage as customers are increasingly factoring environmental practices into purchasing decisions.

FII is committed to providing a broad audience, especially forest product customers in the U.S., Europe, Japan and China with accurate and factual information about forest management in B.C., and about the inherent environmental attributes of B.C. products, to support their purchasing decisions.

Surveying customers, influencers and decision makers is basic to understanding customers' preferences and measuring the effectiveness of FII's activities. FII conducts customer surveys, in partnership with other organizations, to determine trends in the marketplace, customer perspectives and the effectiveness of market communications materials. The results of these surveys guide activities led by Market Outreach staff. In addition, FII regularly surveys the forest sector to determine the usefulness of Market Outreach's activities and recommendations for action.

Performance measures for Goal 2:

To achieve Goal 2, FII's strategies include:

- Gathering market intelligence through research and surveys.
- Producing technically accurate and credible information materials for a broad international and domestic audience.
- Monitoring and analyzing the internet and mainstream and trade media.
- Building and maintaining support for B.C. as world leader in sustainable forest management.
- Positioning the Market Outreach as a credible source of factual information regarding forest management in B.C.
- Providing advocacy support where B.C. forest products are unfairly targeted.
- Conducting in-market activities through trade shows, seminars and meetings with customers.
- Developing and leading forest tours for customers and key influencers.

Measure: Level of key stakeholder support for development and delivery of market outreach program, as measured in bi-annual surveys (on a scale of 1 to 5)					
Target: Substantially achieved					
Past performance		2007/08		Future performance targets	
2005/06	2006/07	Target	Actual	2008/09	2009/10
4.0	No survey	4.0	3.9	No survey	4.0

Importance of measure: Stakeholder support is a direct indicator of the relevance and usefulness of FII's market outreach activities. On a scale from 1 to 10, respondents to the survey conducted in the fourth quarter of 2007/08 rated the importance of FII's Goal 2 as 8.1. On the same scale, the average rating was 7.9 for FII's effectiveness in communicating the fact that the B.C. forestry companies employ sustainable forestry management practices such that the pressure from environmental groups has diminished considerably in recent years. Data is gathered through a bi-annual survey of about 60 industry stakeholders undertaken by an independent research firm.

Measure: Percent of customers who feel that choosing products from B.C. (Canada) is a good choice for the environment					
Target: Not applicable					
Past performance		2007/08		Future performance targets	
2005/06	2006/07	Target	Actual	2008/09	2009/10
91% (2004/05)	93%	No survey	No survey	90%	No Survey

Importance of measure: Customer support reflects the effectiveness of market outreach programs at informing the marketplace about B.C.'s sustainable forest practices and at promoting the environmental benefits of wood products. Data is gathered through a bi-annual survey of about 150 customers, primarily through in-person interviews. Data is collected for the U.S., Europe and Asia every four years with a U.S.-only survey conducted in the alternate survey period. The most recent survey in 2006/07 revealed that customers trusted products coming from British Columbia and Canada more broadly and that these products were believed to be of high quality and coming from sustainable sources. Future surveys will continue to be conducted by an independent research firm.

Highlights in 2007/08

- FII began engagement with the green building movement to raise awareness of the environmental benefits of building with B.C. wood products. The addition of a "green building" component to the Market Outreach Program was added after the completion of the 2007/08 service plan. Specific performance measures will be included in future service plans.
- In conjunction with the Athena Institute, FII began actively promoting "life cycle assessment" to estimate the total environmental footprint of a building, from design through construction, use, and recycling: wood-based structures tend to score favorably compared to concrete, steel and other designs with high energy input costs.
- FII developed a new database tracking green procurement policies and certification commitments among leading global companies listed in key North American, European and Asian stock exchanges.
- The Council of Forest Industries and FII jointly developed a forest product marketing education kit for secondary schools, which will be deployed across the province in time for the 2008/09 school year.

Goal 3: FII is a highly effective, innovative and responsive organization

FII is a highly focused and dynamic organization that maintains flexibility to respond to emerging forest sector needs while maintaining low overhead and operating expenses.

FII is committed to the development and implementation of sound business practices incorporating sound financial controls, a performance management framework and a monitoring, audit and evaluation program built on a comprehensive risk-assessment strategy, all developed in accordance with government policies and guidelines.

Performance measures for Goal 3:

To achieve Goal 3 FII's strategies include:

- Ensuring the integrity of funding to other organizations, FII's investments are provided in a timely fashion for activities that will enhance forest sector well being.
- Implementing a rigorous program of monitoring, auditing and evaluating projects according to explicit risk assessments.
- Ensuring regular and accurate reporting on the results of investments in support of corporate goals and objectives and in accordance with government and contractual requirements.
- Keeping administration costs below 6 percent of total budgeted expenditures.
- Ensuring that staff are afforded ample opportunities for personal development, as well as for formally and confidentially evaluating the FII workplace.

Measure: Timeliness of annual funding cycle for trade associations, research institutes and universities					
Target: Achieved					
Past performance		2007/08		Future performance targets	
2005/06	2006/07	Target	Actual	2008/09	2009/10
Funding available by April 1	Funding available by April 1	Funding available by April 1	Funding available by April 1	Funding available by April 1	Funding available by April 1

Importance of measure: Timeliness of the annual funding competition process is important because about half of FII's budget is used to pay in whole or in part for work proposed and ultimately delivered by other organizations. It is a complex process involving independent ranking of proposals, formally observed the Purchasing Services Branch of the Ministry of Labour and Citizens' Services. FII strives to conclude the process by the start of each fiscal year, provided that a given applicant is ready to sign a funding agreement specifying operational and financial details of all the projects it will undertake.

Shareholder's letter of expectations

For most of 2007/08, FII operated according to direction included in its first Shareholder's Letter of Expectations (SLE), signed by the Minister of Forests and Range in November 2006. That Letter was superseded by a second version in February 2008, which is posted on FII's website. At a high level, the Minister instructed FII to:

- Actively maintain, build and diversify demand for B.C. forest products in Canada and in key world markets
- Help break down trade and market barriers to ensure opportunities for B.C. Wood
- Work with the forest industry to promote B.C.'s world-leading forest products and forest management to the global marketplace
- Help ensure that the forest sector, through strong international sales, continues to be a leading contributor to the B.C. economy.

The Minister also spoke more specifically about:

- Harmonizing export promotion programs with those of the Government of Canada
- Actively participating in the Province's Asia-Pacific Gateway initiatives
- Consulting with the industry Strategy Committee
- The required attributes of the Market Development and Market Outreach Programs;
- Ensuring that the wholly owned subsidiary in China complies not only with normal Canadian business practices, but also with Chinese law
- Participating in a review of the composition of the Board of Directors to be lead by the Shareholder.

One of the specific tasks mentioned in the first SLE related to a review of FII's cost sharing policies. This is important because about half of the company's expenditures are in the form of funding provided to other organizations for activities they propose in response to an annual Call for Proposals, and ultimately deliver. In many cases, the cost of such work is shared among FII, the federal government, and the proponent with the percentages varying by type of activity and by location. In December 2007 the Minister sanctioned an updated cost-sharing policy which was then applied to external funding for 2008/09.

Introduction of the SLE made redundant much of FII's longstanding contract with the Ministry of Forests and Range. Consequently, in 2007 it was replaced by a funding agreement of much narrower scope.

New to the second SLE was an instruction to measure, report on, and reduce FII's greenhouse gas emissions in accordance with government's objectives across the public sector.

Text throughout this annual report identifies how FII has conducted its business in accordance with the SLEs, and confirms that stakeholders generally believe the corporation is doing a good job of pursuing the correct strategies and priorities.

Financial report

Management discussion and analysis

FII began the year expecting to spend a total of \$26.750 million based on equivalent funding from the Ministry. Actual expenditures (including non-cash items), compared to the previous year, were as follows:

	2007/08	2006/07
Actual expenditures	\$23.4 million	\$23.4 million
Payments to other organizations based on annual call for proposals	\$10.4 million, or 44% of total expenditures	\$9.8 million, or 42% of total expenditures

[Note: Actual expenditures were coincidentally the same each year, after rounding to the nearest 100 thousand dollars.]

The above payments to funding recipients covered 45% of the total cost of the relevant cost-shared projects, the remainder being contributed by the federal government and the funding recipients themselves. FII's share was down from 47% the previous year, reflecting a slightly different mix of activities by the funding recipients.

The budget surplus in 2007/08 arose because of under-spending by the funding recipients, and by FII staff. The funding recipients ultimately spent \$2.0 million less than was committed to them when their funding recipient agreements were initiated. This continued a pattern of annual under-spending by trade associations, who were faced with internal pressures to lessen expenditures in 2007 because of the historically low sales revenue to their members. In 2007/08, the funding recipients' under-spending was in:

- **Mountain Pine Beetle Program:** approximately \$0.2 million, mostly because FPInnovations did not proceed with one of seven planned projects.
- **Business Innovation Program:** approximately \$0.4 million because BC Wood Specialties Group and FPInnovations did not begin to implement the program until early 2008.
- **Other Market Development Programs:** \$1.4 million because a number of projects were scaled back, delayed or cancelled by the thirteen funding recipients. Most notable were a delay in implementing the Wood Products Council's non-residential promotion program in the United States, and reduced activity by Canada Wood Group and the Council of Forest Industries in China.

Internally, FII spent \$2.8 million less than originally planned, the significant variances being as follows:

- **Mountain Pine Beetle Program:** \$0.6 million (or 56%) less than planned, primarily because the sole position in the Program was vacant for part of the year, which in turn led to FII being able to engage an industry partner for only two mill recovery studies, rather than the three which had been planned for the year.
- **Business Innovation Program:** \$0.2 million (or 86%) less than planned because the program delivery agents were not ready to begin implementation until late in the year.

- **Market Outreach Program:** \$0.2 million (or 7%) less than originally planned, primarily because two anticipated special projects were not undertaken, namely:
 - improvements to a web-based search engine for locating products from certified forests; and
 - possible re-positioning of the program based on changing customer and consumer perceptions of the forest industry.
- **China Market Development Program:** \$0.8 million less than originally planned, the most significant variances being:
 - two hybrid projects for Beijing and Shanghai were not started (\$0.4 million).
 - roofing demonstration projects came in under budget (\$0.1 million).
 - market research was under-spent (\$0.1 million).
- **Other Market Development Programs:** \$1.0 million less than originally planned, primarily because:
 - A \$0.7 million allocation for leveraging and showcasing wood products in facilities related to the 2010 Winter Olympics and the BC Canada Pavilion for the 2008 Summer Games was ultimately not required.
 - A planned contribution to the "Vancouverism" exhibition during the 2009 London Festival of Architecture was spread over two years, rather than being paid entirely in 2007/08.
 - A major research project of wood product opportunities in the Middle East was deferred to 2008/09 because the competitively selected firm was unable to complete the work as originally planned.
 - Updates and revisions to key FII promotional tools and materials were delayed until 2008/09 so that FII staff could complete a thorough stakeholder review of existing materials and future needs.
 - Mongolian partners were unable to undertake construction of two wood frame housing demonstration units before winter set in. They will be built in 2008/09.

In addition to managing its funding from the Ministry, FII remains responsible for a trust fund on behalf of interested parties in Europe, the United States, Chile and Australia. Those parties share an interest in ensuring that the Government of China adopts a forest management certification system that meets the standards of the Luxembourg-based Program for Endorsement of Forest Certification schemes (PEFC). The parties collectively deposited \$495,000 in a trust fund administered by FII for the sole purpose of hiring a representative in Beijing to work with Chinese officials in development of the China system. In the past year, FII spent \$188,000 from the trust fund, and anticipates continuing this arrangement in the coming year.

While solid financial management is a given, it is perhaps equally important to ensure that expenditures are worthwhile. In 2007/08 FII staff worked closely with funding recipients to create a comprehensive performance management system based on a large array of quantifiable outputs and outcomes. It will be fully implemented in 2008/09.

Looking ahead

FII will continue to aim for a balanced portfolio of expenditures, with about half aimed at protecting and expanding well-established market sectors in the United States, Japan, Europe and Australia, and half aimed at creating demand in other regions, most notably China, Taiwan, Korea and Vietnam.

About three-quarters of the budget will be used to promote the sale of primary forest products, and the remaining one-quarter to promote secondary products.

FII's funding from the Ministry of Forests and Range will be \$2.750 million less in 2008/09 than in 2007/08 because the separate funding for mitigating impacts of the mountain pine beetle epidemic will have ended. Nevertheless, FII will continue its MPB-related activities at a somewhat reduced level within the normal product and market development programs.

Other programs are expected to continue substantially unchanged, except for full ramping up of the Business Innovation Program that was introduced in late 2007. The amount of funding provided to other organizations to support the work they propose and deliver in accordance with FII's investment strategies and priorities will be about \$11.7 million if they undertake all the work that FII agrees to fund. That would amount to about 52% of FII total expenditures, up from 46% in 2007/08.

FII staffing is expected to remain stable at 17 employees in Canada, and seven in China.

In the coming year, FII will craft a formal social responsibility policy that will include a commitment to carbon neutrality and reduction in carbon emissions in line with new Provincial guidelines.

Since nearly half of FII's budget is annually committed to fund the work that other organizations propose, the company is always at risk that they will not deliver what they set out to do, and hence FII will fail to achieve its objectives. To minimize surprises in under-spending by other organizations, FII staff closely monitor their evolving work plans through the year, and frequently re-profile forecasts for the balance of the year, making the Ministry aware of any significant looming surplus so that it can make better use of the funding if it chooses.

FII provides funding to other organizations through quarterly advances, to be reconciled at year-end. Despite close monitoring by FII staff, funding recipients have consistently turned back considerable funding that had been advanced through the year. Typically the reasons are because circumstances have changed in the market place, triggering a change in priorities, or the funding recipients they do not have the human or financial capacity to complete what they had planned. Over the past five years, the accumulated turn-back ranged from \$325,000 to \$650,000.

In early 2008 one of FII's greatest concerns is whether or not the federal government will top up its allocation to the Canada Wood Export Program for 2009/10 and renew the program beyond then. This is critical because FII's funding recipients rely heavily on CWEP funding to develop off-shore markets, especially in Japan, China and Korea. CWEP contributions to relevant cost-shared activities have amounted to about \$7.5 million per year, but without an early top-up, only about \$3.5 million will remain available in the CWEP in 2009/10. No federal funding mechanism is in place beyond that. Absent a commitment by the federal government by the Fall of 2008, private-sector staff are likely to begin looking for alternative employment, putting off-shore market development at serious risk.

The greatest internal risk for FII lies with the potential for staff turnover. FII is a small organization with no redundancies in job content. Every position is unique, and there is little opportunity for anyone to advance within the company as their knowledge and skill sets improve. Finally, the fact that FII is funded on a year-to-year basis can be unsettling to some

employees, as it certainly is for some staff in organizations that rely heavily on FII funding. If anyone leaves to pursue career advancement, there is virtually no internal capacity to fill the gap.

The exposure to potential staff turnover is mitigated by proactively enabling and encouraging every employee to expand his or her scope, to inter-relate with a wide variety of stakeholders and learn from them, and to participate in activities that are not strictly within each position's formal scope. Nevertheless, the company is certain to suffer temporary set-backs with the occasional departure of staff who have out-grown their positions.

In early 2008, FII engaged a consultant to conduct a confidential survey of stakeholder opinions about how well FII has been performing. Another consultant was engaged to confidentially assess employee opinions about working for the company. The results of both surveys were gratifying. External stakeholders confirmed that FII, by and large, is doing a good job in pursuing the right objectives. Internally, every employee said he or she is proud to work at FII and would recommend it to others.

Year-over-year financial data are summarized in the following table.

**Forestry Innovation Investment Ltd.
Statement of Funding and Expenditures By Program
Comparison to Budget and Prior Year**

	Current Year 12 months ended March 31, 2008	Current Year Original Budget	Variance to current year budget	Prior Year 12 months ended March 31, 2007	Prior Year 12 months ended March 31, 2006	Prior Year 12 months ended March 31, 2005	Year of incorporation 12 months ended March 31, 2004
Funding							
Receipts - Province of BC	\$23,408	\$26,750	\$3,342	\$23,367	\$22,416	\$16,454	\$26,531
Total Funding	<u>\$23,408</u>	<u>\$26,750</u>	<u>\$3,342</u>	<u>\$23,367</u>	<u>\$22,416</u>	<u>\$16,454</u>	<u>\$26,531</u>
Expenditures							
International Marketing	13,213	16,382	\$3,169	14,438	14,923	10,686	10,912
China Market Development	3,964	3,393	\$(571)	2,499	1,550	1,287	930
Mountain Pine Beetle	1,980	2,790	\$810	2,178	1,456	-	-
Market Outreach Program	2,587	2,785	\$198	2,434	2,496	2,736	2,784
Corporate Support	1,215	1,400	\$185	1,236	1,394	1,288	1,272
Research	-	-	-	-	-	-	10,633
Amortization	449	-	\$(449)	582	652	547	-
Total Expenditures	<u>\$23,408</u>	<u>\$26,750</u>	<u>\$3,342</u>	<u>\$23,367</u>	<u>\$22,471</u>	<u>\$16,544</u>	<u>\$26,531</u>
Excess of Funding Over Expenditures	<u>\$-</u>	<u>\$-</u>	<u>\$-</u>	<u>\$-</u>	<u>\$(55)</u>	<u>\$(90)</u>	<u>\$-</u>
	-	-	-	-	55	90	-
Retained Earnings end of the year	<u><u>\$-</u></u>	<u><u>\$-</u></u>	<u><u>\$-</u></u>	<u><u>\$-</u></u>	<u><u>\$-</u></u>	<u><u>\$-</u></u>	<u><u>\$-</u></u>

Forestry Innovation Investment Ltd.
3 year forecast 2008-2011

	Budget 08/09 (000's)	Budget 09/10 (000's)	Budget 10/11 (000's)
Revenue			
Contribution from the Province of BC	\$ 24,500	\$ 24,500	\$ 24,500
Transferred from Deferred Revenue	\$ 1,681	\$ 1,217	\$ 75
	<u>\$ 26,181</u>	<u>\$ 25,717</u>	<u>\$ 24,575</u>
Expenses			
Market Development Programs ^{(2) (3) (4)}	\$ 21,820	\$ 21,428	\$ 20,350
Market Outreach Programs	\$ 2,550	\$ 2,550	\$ 2,550
Corporate Services	\$ 1,500	\$ 1,550	\$ 1,600
	<u>\$ 25,870</u>	<u>\$ 25,528</u>	<u>\$ 24,500</u>
Operating Income	<u>\$ 311</u>	<u>\$ 189</u>	<u>\$ 75</u>
Amortization	\$ 311	\$ 189	\$ 75
Net Income	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>
Retained Earnings	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>
Capital Expenditures	<u><u>\$ 25</u></u>	<u><u>\$ 25</u></u>	<u><u>\$ 25</u></u>
FTE's			
Vancouver BC	17	17	17
Shanghai China	7	7	7
⁽²⁾ Includes Mountain Pine Beetle Program expenditures (000's)	\$ 2,000	\$ 2,000	\$ 2,000
⁽³⁾ Includes FII Shanghai (China Program)	\$ 3,100	\$ 3,000	\$ 3,000
⁽⁴⁾ Includes DHC Prepaid lease write off	\$ 1,370	\$ 1,028	\$ -

Statement of Management Responsibility

Forestry Innovation Investment Ltd.

Statement of Management Responsibility

The financial statements of Forestry Innovation Investment Ltd. have been prepared by management in accordance with Canadian generally accepted accounting principles. These statements present fairly the financial position of the Company as at March 31, 2008 and results of its operations and cash flows for the year ending March 31, 2008.

Management is responsible for the integrity of the financial statements and has established systems of internal control to provide reasonable assurance that transactions are properly authorized, assets are safeguarded, and financial records are properly maintained to facilitate the preparation of the financial statements in a timely manner.

The Auditor General of British Columbia has performed an independent audit of the financial statements of Forestry Innovation Investment Ltd. The Auditor's Report outlines the scope of this independent audit and expresses an opinion on the financial statements of Forestry Innovation Investment Ltd.



Ken Baker
Chief Executive Officer



Douglas Greig
Vice President, Finance and
Administration

Vancouver, British Columbia
May 09, 2008

Report of the Auditor General of British Columbia



Report of the Office of the Auditor General of British Columbia

*To the Board of Directors of
Forestry Innovation Investment Ltd., and*

*To the Minister of Forests and Range
Province of British Columbia:*

I have audited the balance sheet of Forestry Innovation Investment Ltd. as at March 31, 2008 and the statements of operations and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Forestry Innovation Investment Ltd. as at March 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*Victoria, British Columbia
May 9, 2008*

John Doyle, MBA, CA
Auditor General

Financial Statements

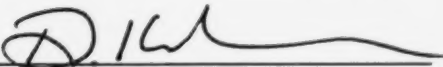
Forestry Innovation Investment Ltd.

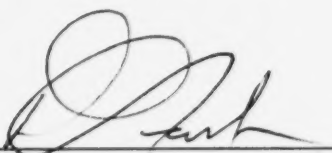
Balance Sheet

(in \$000s)

As at March 31	2008	2007
Assets		
Current assets		
Cash	4,809	5,833
Restricted cash held in trust (note 6)	379	390
Accounts receivable	507	210
Prepaid expenses	527	461
Program advances (note 2,7)	709	683
	6,931	7,577
Dream Home Canada (note 8)	2,397	3,767
Capital assets (Note 9)	689	889
	10,017	12,233
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities (note 2,10)	1,669	1,528
Restricted funds held in trust (note 6)	379	390
Program payables (note 7)	204	714
Due to the Province of British Columbia (note 2,11)	4,486	4,945
	6,738	7,577
Deferred revenue (note 12)	3,279	4,656
	3,279	4,656
Shareholders's equity		
Share capital (note 13)	-	-
Retained earnings	-	-
	10,017	12,233
Commitments (note 14)		

On behalf of the Board


Director


Director

The accompanying notes and supplementary schedule are an integral part of these financial statements.

Financial Statements

Forestry Innovation Investment Ltd.

Statement of Operations and Retained Earnings

(in \$000s)

For the year ended March 31	2008	2007
Revenue		
Contribution from the Province of British Columbia	23,408	23,367
	23,408	23,367
Program costs		
Market Development Programs		
Market Development	13,213	14,438
China Market Development	3,964	2,499
Mountain Pine Beetle	1,980	2,178
Total Market Development Programs	19,157	19,115
Market Outreach	2,587	2,434
Corporate Support	1,215	1,236
Amortization	449	582
	23,408	23,367
Excess of revenue over expenditures	-	-
Retained earnings end of the year	-	-

The accompanying notes and supplementary schedule are an integral part of these financial statements.

Forestry Innovation Investment Ltd.

Statement of Cash Flows

(in \$000s)

For the year ended March 31	2008	2007
Cash flows used in operating activities:		
Excess of revenue over expenditures	-	-
Items not involving cash:		
Amortization of capital assets	449	582
Amortization of Dream Home Canada lease	1,370	342
	1,819	924
Changes in non-cash working capital	(1,217)	4,307
	602	5,231
Cash flows from investing activities:		
Dream Home Canada construction costs	-	(37)
Purchase of capital assets	(249)	(529)
	(249)	(566)
Cash flows from financing activities:		
Decrease in contributed surplus	-	-
Repayment of capital lease	-	-
Change in deferred revenue	(1,377)	(288)
	(1,377)	(288)
Decrease in cash during the year	(1,024)	4,377
Cash beginning of year	5,833	1,456
Cash end of year	4,809	5,833

The accompanying notes and supplementary schedule are an integral part of these financial statements.

Financial Statements

Forestry Innovation Investment Ltd.

Schedule of Expenditures by Business Segment

for the year ended March 31, 2008

(in 000's)

	Market Development	China Market Development	Mountain Pine Beetle	Market Outreach	Administration	2008 Total	2007 Total
Amortization	-	64	-	-	385	449	582
Auditing	252	5	-	-	35	292	150
Communications	62	-	-	-	16	78	110
Conferences and Trade Shows	1,122	117	-	499	-	1,738	2,127
Development Costs	-	-	-	-	-	-	47
Extraordinary Items	-	-	-	-	-	-	-
Grants	658	-	-	10	-	668	1,125
Marketing	-	263	-	-	-	263	234
Office	111	377	14	126	190	818	660
Lease Amortization	-	1,370	-	-	-	1,370	342
Performance Management	121	-	-	-	-	121	88
Professional Services	64	155	-	135	117	471	730
Publishing	157	-	-	124	-	281	103
Strategy & Research Studies	483	136	1	881	-	1,501	1,054
Trade Missions	15	-	-	-	-	15	24
Travel & Business Costs	149	177	30	90	164	610	395
Wages and Benefits	495	572	95	415	673	2,250	1,808
Websites	20	-	-	45	-	65	15
Program Costs	9,504	792	1,840	262	20	12,418	13,773
Total	13,213	4,028	1,980	2,587	1,600	23,408	23,367

Notes to the Financial Statements

March 31, 2008

1) Nature of business

Forestry Innovation Investment Ltd. (the Company), was incorporated on March 31, 2003 under the laws of British Columbia. A board of directors, all appointed by the government of British Columbia, governs the Company.

Market Development Program - uses project funding and partnerships with the Government of Canada, forest industry associations and research institutions, to:

- maintain and create opportunities for BC wood products in existing and emerging markets;
- ensure BC forest products have access to markets free from regulatory and other barriers;
- ensure buyers, consumers, designers, builders, developers and architects know about BC wood products and the many positive features they bring to wood-frame construction and interior finishing;
- support the development of innovative new forest products, including products using pine harvested from mountain pine beetle-attacked forests; and,
- provide markets and audiences with information on the properties and qualities of BC's premier forest products as well as the BC companies that supply them.

Market Outreach Program - is an in-house FII program that provides international buyers and others with credible facts that BC forest products come from well-managed forests.

Environmental campaigns that promote misleading or incorrect information are quickly challenged by FII and its partners. They also monitor the development of draft legislation and procurement policies that could impair the flow of BC forest products into a particular market, making relevant officials aware of frequently unintended consequences if the legislation or policy is adopted.

The Company is exempt from federal and provincial income taxes.

2) Prior Year Adjustments

During the year, management identified the following:

- Certain program expenditures relating to recipient agreements that were previously expensed, that should have been recorded as program advances. The adjustment to reflect program advances has been applied retrospectively, which increased current assets and decreased program costs by \$683,408 at March 31, 2007.
- Certain program expenditures that should not have been accrued as payable. The adjustment to accruals has been applied retrospectively, which reduced accounts payable and accrued liabilities and program expenditures by \$379,238 at March 31, 2007.

The effect of these adjustments resulted in an increase in the amount due to the Province of British Columbia and a decrease in the contribution from the Province of British Columbia of \$1,062,646. There was no impact on net assets at March 31, 2007 or on net income for the year then ended. See the following for detail by program area.

Program Area	2007
Market Development	916
Mountain Pine Beetle	33
Market Outreach	114
Total	<u>1,063</u>

3) Significant accounting policies

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Significant accounting policies followed in the preparation of these financial statements are:

a) Consolidation

In 2004, the Company incorporated FII Consulting (Shanghai) Co., Ltd., a wholly owned subsidiary registered under the laws of the People's Republic of China.

Based in Shanghai the subsidiary administers market development programs on behalf of FII. Chinese law imposes restrictions on the distribution of earnings and assets from the subsidiary to its parent, hence FII Consulting (Shanghai) Co.' working capital has been disclosed as a program payable on the balance sheet (See Note 7).

b) Asset Under Capital Lease

The Company entered into an agreement with a development company in China with respect to the construction and lease back of a demonstration centre and wood frame construction villas called Dream Home Canada. Construction of this project was completed December 31, 2006. All costs were capitalized at that time and are now being expensed over a three-year period starting January 1, 2007.

c) Capital assets

Capital assets are recorded at cost and amortization is being calculated on the straight-line basis using the following rates:

Computer Equipment	3 years
Computer Software	2 years
Furniture and Equipment	5 years
Leasehold Improvements	Term of Lease
Trade Show Booths	3 years
Website development Costs	2 years

Assets costing less than \$1,000 are expensed in the year of acquisition.

d) Revenue recognition

Contributions from the Province of British Columbia are for specific purposes and as such are deferred and recognized as revenue as the expenses are incurred.

e) Foreign currency translation

Any foreign currency transactions are translated into Canadian dollars at the rate of exchange in effect at the transaction date.

Any foreign currency denominated monetary assets and liabilities are stated using the prevailing rate of exchange at the balance sheet date.

f) Use of estimates

The preparation of financial statement in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts and disclosure of assets and liabilities at the date of the financial statements. Actual results could differ from these estimates.

4) Change in Accounting Policy

Effective April 1, 2007 Forestry Innovation Investment Ltd. has adopted the new standard announced by the Canadian Institute of Chartered Accountants (CICA) Section 3855, *Financial Instruments – Recognition and Measurement*. Under the new standards, all financial assets must be classified as held-to-maturity, loans and receivables, held-for-trading or available-for-sale and all financial liabilities must be classified as held-for-trading or other financial liabilities. Financial instruments classified as held-for-trading will be measured at fair value with changes in fair value recognized in net income. Financial assets classified as held-to-maturity or as loans and receivables and financial liabilities not classified as held-for-trading will be measured at amortized cost. This accounting policy was adopted on a prospective basis with no restatement of prior period financial statements.

5) Financial instruments

As of March 31, 2008, Forestry Innovation Investment Ltd. has designated its Financial Instruments as follows:

Cash is classified as held for trading and measured at fair value and all gains and losses are included in income in the period in which they occur. Accounts receivable are classified as loans and receivables and are measured at amortized cost. Accounts payables, accrued liabilities, program payables and amounts due to related parties are classified as other financial liabilities and are also measured at amortized cost.

At March 31, 2007, the company's financial instruments includes cash, accounts receivable, amount due to the Province of British Columbia, accounts payable and accrued liabilities and program payables. The fair values of the company's financial instruments approximate carrying amounts due to their short-term nature. It is management's opinion that the company is not exposed to significant interest, currency or credit risks arising from these financial instruments.

6) Restricted cash held in trust

In the previous year the company entered into a joint venture agreement with members of the "Programme for the Endorsement of Forest Certification" (PEFC), an organization promoting an internationally credible framework for forest certification schemes and initiatives in countries around the world. In conjunction with this effort, the company and its subsidiary, FII Consulting (Shanghai) Co., Ltd agreed to financially administer the moneys contributed to the program by the joint venture partners.

7) Program advances and payables

The company advances funds to recipient organizations during the year, based on recipient funding contracts, to carry out program activities. Historically these unspent advances have been repaid back to FII prior to the end of the first quarter of the new fiscal year after fourth quarter reports have been submitted and final audits have been completed. At March 31, 2008, \$709,000 has been identified as repayable by the recipients and has been set up as program advances (2007 - \$683,000).

Program payables at March 31, 2008 of \$204,000 (2007 - \$714,000) relate to the net working capital at March 31, 2008 of Forestry Innovation Investment Ltd.'s subsidiary company, FII Consulting (Shanghai) Co., Ltd. This amount represents the net amount payable for programs being carried out by the subsidiary. The balance of program payable to FII China is comprised of the following elements:

	<u>2008</u>	<u>2007</u>
Cash	(392)	(115)
Accounts receivable	(43)	(32)
Accounts payable	<u>639</u>	<u>861</u>
Total	<u>204</u>	<u>714</u>

8) Dream Home Canada

	<u>2008</u>	<u>2007</u>
Asset under capital lease	3,767	4,109
Amortization	<u>(1,370)</u>	<u>(342)</u>
	<u>2,397</u>	<u>3,767</u>

9) Capital assets

	<u>2008</u>		<u>2007</u>	
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Computer equipment	449	287	162	231
Computer software	125	118	47	17
Furniture and equipment	275	161	114	133
Leasehold improvements	175	80	95	0
Tradeshow booths	1,504	1,272	232	499
Websites	471	392	79	9
	<u>2,999</u>	<u>2,310</u>	<u>689</u>	<u>889</u>

Cost includes the fair market value of certain assets transferred to the Company from the Province effective April 1, 2003, for one dollar. These assets are now fully depreciated.

10) Accounts payable and accrued liabilities

	2008	2007
Trade payables	792	433
Accrued liabilities	877	1,095
	<u>1,669</u>	<u>1,528</u>

11) Due to the Province of British Columbia

	2008	2007
Balance, beginning of the year	4,945	614
Funds received for current year operations	26,221	27,520
	<u>31,166</u>	<u>28,134</u>
Payments refunded back to the Province	(4,946)	(614)
Prior year program recoveries	0	205
Interest earned during the period	297	299
Program expenditures	(23,408)	(23,367)
Change in Dream Home Canada assets net of pre-paid lease expense	1,370	305
Change in capital assets net of amortization	200	53
Advances against program expenditures	(193)	0
Adjustment to deferred revenue	0	(70)
Due to the Province end of the year	<u>4,486</u>	<u>4,945</u>

Change in Dream Home Canada assets net of prepaid lease expense represents construction costs during the year of \$0 (2007 - \$37,000) less lease expense of \$1,370,000 (2007 - \$342,000).

Change in capital assets net of amortization represents assets acquired during the year of \$249,000 (2007 - \$529,000) less amortization of \$449,000 (2007 - \$582,000)

12) Deferred revenue

The company defers contributions received from the Province of British Columbia used for the acquisition of Dream Home Canada and capital assets and recognises the revenue as these assets are amortized. The Deferred revenue account, therefore, will increase by the purchase of assets and decrease by the amortization of those assets including Dream Home Canada prepaid lease expense.

	2008	2007
Balance, beginning of the year	4,656	4,944
(Decrease)/Increase in Dream Home Canada construction costs net of prepaid lease expense	(1,370)	(305)
(Decrease)/Increase in capital assets net of amortization	(200)	(53)
Advances against program expenditures	193	0
Adjustment	0	70
Balance, end of the year	3,279	4,656

13) Share capital

The Company has authorized capital of 100 common shares without par value of which 10 shares are issued and outstanding. The Minister of Forests holds the shares issued as the designated representative of Her Majesty the Queen in right of the Province of British Columbia.

14) Commitments

The Company has lease commitments for the premises it occupies at 1130 West Pender and kiosk space at the Tsawwassen Ferry Terminal as follows:

	<u>Lease Amount</u>
March 2009	179
March 2010	178
March 2011	161
March 2012	157
March 2013	118
	<u>793</u>

The Company also has an obligation to pay \$385,312 in fiscal 2008/2009 for contracts entered into and not yet completed at March 31, 2008.

15) Related party transactions

The Company is related through common ownership to all Province of British Columbia ministries, agencies and crown corporations. Transactions with these entities, unless disclosed separately in these financial statements, are generally considered to be in the normal course of operations and are recorded at the exchange amount.

16) Comparative Figures

Certain figures for 2007 have been reclassified to make their presentation consistent with that adopted in 2008.



Contact information

1200—1130 West Pender Street
VANCOUVER BC V6E 4A4
Phone: 604 685 7507
Fax: 604 685 5373
E-mail: info@bcfii.ca
www.bcfii.ca

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